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703257—46

In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 245

ROY G. FITZGERALD, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 8–12) are not reported. The decision of the Circuit Court of Appeals (R. 33) is reported at 154 F. 2d 1017.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 10, 1946. (R. 33.) A petition for rehearing (R. 34–37) was denied May 29, 1946 (R. 38). Petition for a writ of certiorari was filed on June 29, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of

the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether petitioner was entitled to a bad debt deduction in 1941 under Section 23 (k) (1) of the Internal Revenue Code, as amended.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME. [As originally enacted]
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (k) *Bad Debts.*—
>
> (1) *General Rule.*—Debts ascertained to be worthless and charged off within the taxable year * * *
>
> * * * * *
>
> (26 U. S. C. 1940 ed., Sec. 23.)

Revenue Act of 1942, c. 619, 56 Stat. 798.

> SEC. 124. DEDUCTION FOR BAD DEBTS, ETC.
>
> (a) General Rule.—Section 23 (k) (relating to bad debts and securities becoming worthless) is amended to read as follows:
>
> "(k) *Bad Debts.*—
>
> "(1) *General Rule.*—Debts which become worthless within the taxable year; * * *
>
> (26 U. S. C., Supp. V, Sec. 23.)
>
> * * * * *
>
> (d) *Effective Date of Amendments.*—The amendments made by this section add-

ing the last sentence of section 23 (k) (1) and adding section (k) (4) shall be effective only with respect to taxable years beginning after December 31, 1942; the amendment inserting section 23 (k) (5) and amendments related thereto shall be applicable only with respect to taxable years beginning after December 31, 1941; and the other amendments made by this section shall be effective with respect to taxable years beginning after December 31, 1938.

Treasury Regulations 103, promulgated under the Internal Revenue Code:

> SEC. 19.23 (k)–1 [As amended by T. D. 5234, 1943 Cum. Bull. 119]. *Bad Debts.*—(*a*) Bad debts may be treated in either of two ways—
>
> (1) By a deduction from income in respect of debts which become worthless in whole or in part, or
>
> * * * * *
>
> (*b*) If, from all the surrounding and attending circumstances, the Commissioner is satisfied that a debt is partially worthless, the amount which has become worthless during the taxable year shall be allowed as a deduction in computing net income. * * * If a debt becomes wholly worthless during the taxable year, the amount thereof which has not been allowed as a deduction for any prior taxable year shall be allowed as a deduction for the taxable year. * * * In determining whether a debt is worthless in whole or in part the

> Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. * * *
>
> Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. * * *

STATEMENT

The facts as found by the Tax Court are as follows:

Petitioner is a resident of Dayton, Ohio, and a lawyer by occupation. In computing his taxable income on his 1941 income tax return he deducted $4,452.72 as a debt which became worthless in that year. The debt consisted of money advanced to his daughter, Ruth F. Hume, and her husband, Thomas L. Hume, Jr. Its amount is based upon a statement furnished the petitioner by his son-in-law, setting out the various advances and computing a total of $4,452.72. The correct total of the items listed is $4,352.72. (R. 8.)

Thomas L. Hume, Jr., married petitioner's daughter in 1923. The couple have three children and in 1941 lived in their own home in Washing-

ton, D. C., which they had purchased in 1925. Thomas L. Hume, Jr., has been, for many years, employed as a salesman of investment securities on a commission basis and in 1941 was so employed by his father, a securities dealer in Washington, D. C. (R. 8.)

During the period 1933 to 1936, Thomas L. Hume, Jr., was in straitened financial condition due to the depression and lack of activity on the security market. During this period, at his and his wife's request, the petitioner advanced them various sums of money totaling $4,352.72. Of this total, $884.13 was evidenced by promissory notes, all of which were signed by Hume and his wife except one signed by Hume alone. The notes carried interest after maturity. The other items were advanced upon request by Hume and his wife but no note was requested or given. These advances by petitioner were for the purpose of supplying the funds with which Hume paid premiums upon his insurance policies, interest and principal on the loan on his home, as well as general living expenses and doctors' bills. Of the total, $700 was advanced for the purpose of defraying the expenses of Hume moving his family to New York to accept a position there with a security house. (R. 8–9.)

Petitioner at various times wrote his daughter and son-in-law inquiring as to their financial condition and asking for repayment, but during the years following 1936 the income of the son-in-law

was not more than the actual amount needed to pay the normal expenses of maintaining his family and no repayment was made. (R. 9.)

Thomas L. Hume, Jr., and his wife, in 1941, were occupying their home at 3114 45th Street, N. W., Washington, D. C. The title to this property stood in both of their names. It had been purchased in March, 1925, for $12,500. It is located in Wesley Heights, one of the best residential sections of Washington. Subsequent to its purchase there had been many public improvements, tending to increase the value of property at that location. After its purchase, the Humes built a garage and added a maid's room to the house. In 1941 the property was worth not less than $12,000. At that time it was encumbered with a first mortgage of $5,489.15 and a second mortgage of $550. In that year Hume was indebted for a bank loan of $500. (R. 9.)

In 1941 petitioner communicated with Hume and advised him that it was his intention to claim a deduction on his income tax return for that year in the total amount of his above-mentioned advances. In response Hume prepared a statement from his records of the various advancements, expressed regret at his inability to pay and assured petitioner that he would do anything that he could to aid him in securing the allowance of the deduction. Sometime prior to the close of the year 1941, petitioner wrote a Washington attorney who was a close friend of his and a friend of

Hume, asking him to look into the matter and collect from Hume the indebtedness or advise him as to the possibility of collection. The attorney, after talking with Hume, advised petitioner orally against filing suit and stated that in his opinion a judgment would not be collectible. This opinion he confirmed in the following year by letter. (R. 9–10.)

The amounts advanced by petitioner to his son-in-law and daughter in a total of $4,352.72 represented an indebtedness on their part to him. The advances were made with the expectation of repayment. (R. 10.)

The Tax Court accordingly found, as an ultimate fact, that the Hume debt did not become worthless in 1941. (R. 10.)

On the basis of those findings, the Tax Court held that petitioner was not entitled to a bad debt deduction for the year 1941. (R. 10–12.) The Circuit Court of Appeals affirmed upon the grounds and for the reasons set forth in the findings of fact and opinion of the Tax Court. (R. 33.)

ARGUMENT

Petitioner's principal contention is that his right to a bad debt deduction should not have been determined with reference to Section 124 (a) and (d) of the Revenue Act of 1942, *supra,* pp. 2–3, which retroactively amended Section 23 (k) (1) of the Internal Revenue Code, *supra,* p. 2, to allow deductions for "Debts which become worth-

less within the taxable year" instead of "Debts ascertained to be worthless and charged off within the taxable year," as previously provided by the Code. (Br. 10–11.) This contention is not sound. In any event, as we show *infra*, p. 9, whichever provision he applied, petitioner cannot establish that he is entitled to the deductions claimed. Thus the case fails to raise any question requiring settlement by this Court.

Since the 1942 amendment was made retroactive "with respect to taxable years beginning after December 31, 1938," there plainly is no merit to petitioner's position that the amendment does not cover his claim for a deduction in 1941. See *Cittadini* v. *Commissioner*, 139 F. 2d 29 (C. C. A. 4); *Meltzer* v. *Commissioner*, 154 F. 2d 776 (C. C. A. 2) pending upon petition for a writ of certiorari, No. 239, this Term. Certainly the dissenting opinion of Judge Learned Hand in *Meltzer* v. *Commissioner, supra*, on which petitioner relies (Br. 10), furnishes no support for a contrary conclusion. Judge Hand interpreted the quoted language as meaning that deductions for debts which became worthless prior to December 31, 1938, are to be determined under the former law. This interpretation is not the same as petitioner's assumption (Br. 10) that the date the Hume debt originally arose is controlling. Moreover, regardless of its merits, Judge Hand's interpretation does not apply here. Petitioner's own testimony before the

Tax Court (R. 27–28) indisputably shows that the Hume debt did not become worthless prior to December 31, 1938, or even prior to 1941 and the Tax Court held that the debt had not become worthless by or in 1941 (R. 11–12).

Petitioner's contention that the application of the amended statute deprives him of due process is based on his assumption that the statute deprives him "of all right of deduction." (Br. 10.) He has in fact been deprived of nothing and is not in a position to complain of the retroactivity of the 1942 amendment on constitutional grounds. As already stated, his testimony before the Tax Court showed that the Hume debt did not become worthless prior to 1941. He therefore never was entitled to a deduction for the debt in any prior year, since a showing of worthlessness has been prerequisite to a deduction under Section 23 (k) (1) both before and after the 1942 amendment. *Spring City Co.* v. *Commissioner,* 292 U. S. 182, 185–189; *Mayer Tank Mfg. Co.* v. *Commissioner,* 126 F. 2d 588 (C. C. A. 2); *Rockefeller* v. *Nunan,* 142 F. 2d 354 (C. C. A. 2), certiorari denied, 323 U. S. 732; *Herder* v. *Helvering,* 106 F. 2d 153, 157 (App. D. C.), certiorari denied, 308 U. S. 617; *Allen-Bradley Co.* v. *Commissioner,* 112 F. 2d 333 (C. C. A. 7); *H. D. Lee Mercantile Co.* v. *Commissioner,* 79 F. 2d 391 (C. C. A. 10). And so far as 1941 is concerned, he is not required to prove as much under the amended statute as he

would have had to prove under the former statute.[1] Moreover, the retroactivity of the 1942 amendment has been judicially approved on the ground that deductions are matters of legislative grace. *Cittadini* v. *Commissioner, supra; Meltzer* v. *Commissioner, supra.*

Contrary to the petitioner's position (Br. 11), the amended statute is not *ex post facto.* To be such it must have operated retroactively to impose a penalty, fine or imprisonment on petitioner. *Calder* v. *Bull,* 3 Dall. 386; *Thompson* v. *Utah,* 170 U. S. 343. While petitioner may be correct in stating that the 1942 amendments to the Internal Revenue Code added a new penalty to the Code (Br. 11), the retroactivity of the amendment to Section 23 (k) (1) obviously did not have the effect of making petitioner subject to that penalty.[2]

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[1] Section 23 (k) (1) was amended because "considerable difficulty" was caused by the additional requirements of the former statute that the taxpayer prove that he had "ascertained" the debt to be worthless and had charged it off during the taxable year. H. Rep. No. 2333, 77th Cong., 2d Sess., p. 44, par. 3 (A). This difficulty appears to have stemmed from conflicting views as to whether an objective or subjective test should be applied in determining whether the deduction had been claimed in the proper year. See, e. g., *Rosenthal* v. *Helvering,* 124 F. 2d 474 (C. C. A. 2); *Mayer Tank Mfg. Co.* v. *Commissioner, supra; Reading Co.* v. *Commissioner,* 132 F. 2d 306 (C. C. A. 3), certiorari denied, 318 U. S. 778.

[2] The statute petitioner relies upon provides only that one who "willfully" makes and subscribes a return "which he

Finally, there is no conflict between the decision below, which adopts the opinion of the Tax Court, and Section 19.23 (k)–1 of Treasury Regulations 103, *supra*, pp. 3–4. Petitioner's assertion of conflict (Br. 9) seems to be premised solely upon the assumption that the District of Columbia statute of limitations barred legal action on the Hume debt. Aside from the fact that this assumption is without question erroneous,[3] the plain language of the Regulations makes it clear that a deduction is not allowable simply because a debtor may have a legal defense to a suit to enforce payment; a showing of worthlessness and uncollectibility is also required. And see *H. D. Lee Mercantile Co.* v. *Commissioner*, 79 F. 2d 391 (C. C. A. 10).[4] The question of worthlessness is one of fact on which the decision of the Tax

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does not believe to be true or correct as to every material matter" shall be guilty of a felony and subjected to the penalties prescribed for perjury. (Br. 11.)

[3] Under the District of Columbia Code (1940), Section 12–305, a written acknowledgment of the debt or promise to pay tolls the running of the statute. Among the photostat exhibits filed in this case are copies of several letters in which Hume acknowledged his debt to petitioner in 1941. Accordingly, it would appear that the Tax Court was correct in stating that in 1941 the Humes' debt not only was not worthless but "in all probability collectible in full, if petitioner had been willing to take legal steps to enforce his collection by sale of the Hume home." (R. 11–12.)

[4] *Duffin* v. *Lucas*, 55 F. 2d 786, 795 (C. C. A. 6), certiorari denied, 287 U. S. 611, relied upon by petitioner (Br. 9), does not hold to the contrary. In that case, which involved an

Court is conclusive unless without rational basis in the evidence. *Boehm* v. *Commissioner,* 326 U. S. 287. If, however, petitioner's argument on this point should be interpreted as a contention that the Tax Court's conclusion that the Hume debt did not become worthless in 1941 has no support in the record, it is sufficient to point out that petitioner himself testified before the Tax Court that he made the loan to the Humes because Mr. Hume was an able-bodied man with earning capacity, that Hume "should and ought, in due course, to repay every bit of it," and "I still think that there is a chance of the loan being collected some day." (R. 29.)

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application of the former statute, the taxpayer claimed a bad debt deduction in 1920, which was two years after the expiration of the period of limitations. The question was whether the taxpayer had claimed the deduction in the wrong year. The court held that he had, but only because he had failed to show that the statute of limitations had not run because of absence, minority, a new promise to pay, etc., or that in 1918 he had substantial reason to think he might nevertheless eventually get part payment.

CONCLUSION

The decision below is correct and involves no conflict of decisions or important question of law. The petition for a writ of certiorari should therefore be denied.

Resectfully submitted,

J. HOWARD MCGRATH,
Solicitor General.

DOUGLAS W. MCGREGOR,
Assistant Attorney General.

SEWALL KEY,
ROBERT N. ANDERSON,
MELVA M. GRANEY,
Special Assistants to the Attorney General.

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